No. 3996

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

C. L. BOSS,

Appellant,

vs.

THE UNITED STATES OF AMERICA, BOSS & PEAKE AUTOMOBILE COMPANY, a Corporation, and E. W. A. PEAKE,

Appellees.

Brief of Appellee, The United States of America

Upon Appeal from the United States District Court for the District of Oregon

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STATEMENT OF THE CASE.

The pertinent facts in this case are stated very clearly in the trial court's opinion (Trans. P. 36), and we desire to add very little thereto.

The Boss & Peake Automobile Company was organized and incorporated under the laws of the State of Oregon on November 8, 1916, with a capital stock of $30,000.00 divided into three hundred shares of $100.00 each. Of these shares Boss subscribed 149, Peake 149 and W. H. Bietau 2 shares. Subsequently Miss Bietau assigned one of her shares to R. E. Murphy.

Miss Bietau and Murphy were mere holding stockholders for Boss and Peake respectively and in reality Boss and Peake were equal owners of the capital stock, each owning 150 shares, and each having paid into the concern as capital investment the full par value thereof.

The corporation at once entered upon the business for which it was organized and the status of the stockholders remained the same until June 1, 1917, when Peake transferred his stock to Boss, and the holding shares were so transferred that the entire capital stock was under the control of Boss and his representatives.

There had been a lack of harmony between the two main stockholders and during the month of March, 1917, Peake offered to sell his stock to Boss and a memorandum agreement was drawn up (Peake's Exhibit "A," Trans. P. 172 et seq.), reciting that Boss and Peake had agreed that Peake should sell his stock in the corporation to Boss and providing for the means of arriving at the value of same. However, after the agreement was drawn up Peake refused to sign the agreement and nothing further was done in the matter until about the 21st of May, 1917. At that time, following a conversation held at the Union Station in Portland, Peake agreed to sell his stock in the corporation to Boss for a consideration of $25,000.00 plus salary allowance and allowance for office furniture owned by Peake in the amount of $1137.15. This was agreed to at the time by both parties and the final transfer of stock took place on June 1, 1917, upon payment by Boss of the sum of $26,137.15, which was given to Peake in the form of Boss' personal check for that amount.

The books of the corporation show beyond any doubt that the total assets of the corporation were $52,746.64 and that the profits of the company on June 1, 1917, were $22,746.64. Peake claimed that the

price set by him upon this stock was a flat rate and was not in intent or effect a division of the assets.

Boss secured the money to pay Peake by the following means: he gave to Peake eight notes attached to warehouse receipts, each in the amount of $1200.00, offering as security eight Hudson automobiles, for which Peake gave Boss a check for $9600.00, which was deposited by Boss in his personal account. Boss further negotiated a personal loan from outside sources in the amount of $8000.00, and borrowed from the corporate funds $8537.15, which amount was charged against him personally upon the books of the corporation.

Peake, on May 31, tendered to the Board of Directors and stockholders of the corporation his resignation as Secretary, Treasurer and Director of such company. On the same day at a stockholders meeting at which were present C. L. Boss, representing 298 shares, R. J. McRell 1 share, and R. E. Murphy 1 share, his resignation was accepted and McRell was elected director in his stead.

On June 22, 1917, a meeting of the directors and stockholders of the corporation was held, at which time the corporation was formally dissolved.

The bank account of the corporation had been con-

tinued and business had been done as usual until June 19, 1917. Between that date and the 22nd of June, a bill of sale was executed by the corporation transferring all its assets to the C. L. Boss Automobile Company, which was a co-partnership composed of C. L. Boss and R. J. McRell.

The books of the corporation show that on June 1, 1917, $22,746.64 was carried in the profit and loss account and that against that account $10,000.00 was charged as being the premium on Peake's stock, $11,-373.32 was credited to Boss and $1373.32 passed to surplus account and subsequently divided between Boss and McRell, according to their several interests in the co-partnership subsequently formed. There was never an inventory made up of the entire assets of the corporation brought down to the date of the transaction.

Boss claims that this surplus of $2,746.64 was agreed upon by himself and Mr. Peake as a sufficient amount to cover the current obligations of the corporation and it was not in fact a profit to be divided between himself and Mr. McRell.

Then follows the assessment of the tax against the corporation, which occurred in 1920, and Boss' payment of one-half the amount and his claim that the balance was due from Peake.

It is admitted by appellant that that portion of the tax which was assessed for the year 1916 is rightfully assessed against the corporation. There is also no dispute as to the validity of the assessment of the taxes for the year 1917.

POINTS AND AUTHORITIES.

This appellee takes the position that the findings of the trial court as to the validity and amount of the tax due and the decree that the appellant is liable for the tax should be sustained. We are not concerned with any private agreements or transactions between the appellant and the appellee, Peake. Therefore, this appellee will confine its argument to the following points:

I.

The income and excess profits tax provisions of the Act of October 3, 1917, are retroactive to January 1, 1917, by the express terms of the act. Act of October 3, 1917, (40 Stat. 30), Title 1, Sections 1 and 4; Title 2, Section 200; Title 13, Section 1302; Section 10, Title 2, Act of September 8, 1916.

II.

The act is not unconstitutional by reason of retroactive operation.

Flint vs. Stone Tracy Co., 220 U. S. 107.

Brushaber vs. Union Pacific Railroad Co., 240 U. S. 1,

Lynch vs. Hornby, 247 U. S. 339, 343,

Brady vs. Anderson, 240 Fed. 665,

U. S. vs. McHatton, 266 Fed. 602.

III.

The effect of making the act retroactive to January 1, 1917, was to make it applicable to a corporation doing business after December 31, 1916, and dissolved prior to the passage of the act.

Florida Central R. R. Co. vs. Reynolds, 183 U. S. 471, 475.

Brady vs. Anderson, 240 Fed. 665.

United States vs. McHatton, 266 Fed. 602.

IV.

The assets of a corporation, if its debts are not paid before dissolution, become a trust fund chargeable with the debts of the corporation.

Wood vs. Dummer, 3 Mason 308, Fed. Cas. 17944.

Mumma vs. The Potomac Company, 8 Pet. 281.

Marr vs. The Bank of West Tennessee et al., 4 Cald. 471, 479.

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United States vs. McHatton, 266 Fed. 602.

People vs. National Trust Co., 82 N. Y. 282.

Marshall vs. People of State of New York, 41 Sup. Ct. 143.

First National Bank of Houston et al. vs. Ewing et al., 103 Fed. 168.

V.

The stockholders' liability is several and may be enforced against one or more of the stockholders to the extent of the distributive share of the corporate assets actually received.

Pierce et al. vs. United States, 41 Sup Ct. 365.

United States vs. McHatton, 266 Fed. 602.

Fidelity Trust Company vs. McKeithen Lumber Co., 212 Fed. 229.

Garrow et al. vs. Fraser et ux., 167 Pac. 75 (Wash.)

Martin vs. City of Lexington, 210 S. W. 483 (Ky.)

McLean vs. Moore, 145 S. W. 1074.

Hastings vs. Drew, 76 N. Y. 9.

Volume 4, Thompson on corporations, Second Edition, Section 4926.

Fricks vs. Augemeier, 101 N. E. 329.

VI.

The conclusion of the lower court as respects the question of fact is entitled on appeal to great weight and will not be reversed unless the complaining party succeeds in showing very clearly that it was erroneous and ought to be overruled.

Board of Commissioners vs. Irvine, 126 Fed. 689, 698.

Snider vs. Dobson, 74 Fed. 757.

Thallmann vs. Thomas, 111 Fed. 277.

The Order of United Commercial Travellers of America vs. McAdam, 125 Fed. 358.

ARGUMENT.

I.

Section 10, Title 2, Act of September 8, 1916, provides:

> "That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon each income, * * * *"

Section 4, Title 1, Act of October 3, 1917, provides as to the income tax in question as follows:

> "That in addition to the tax imposed by subdivision (a) of Section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation, joint-stock company or associatin, or insurance company, subject to the tax imposed by that subdivision of that section, * * * *"

It will be seen from the above section that a tax is levied upon every corporation receiving income during the year 1917. The evidence in this case shows beyond a doubt that the Boss & Peake Automobile Company did business during the year 1917 and hence by the terms of the Act is a corporation which can be taxed. It will be seen that any retroactive feature of these proceedings is authorized by the express terms of the act itself. Therefore, the courts will sustain such retroactive operation, unless the provisions of the act are unconstitutional.

II.

Prior revenue acts, which by their terms were retroactive, have been sustained as constitutional by the courts. It has been the practice of Congress in framing income tax laws and excise tax laws, when the measure of the tax was annual income, to make such laws retroactive to the first day of the year in which they were enacted. In the case of the first income tax law after the adoption of the sixteenth amendment to the constitution, the Act of October 3, 1913, Congress provided that it should be retroactive from a date soon after the adoption of the amendment. Such acts have been uniformly held not in derogation of the constitution, so far as retroaction was concerned. The authorities cited under Section 2 of the Points and Authorities amply sustain this contention. Since the decision of the Supreme Court in the case of Stockdale vs. Insurance Companies, 20 Wall 323, 331, the contention that Congress has no power to enact laws to operate retroactively is no longer open. It was said in that case that:

> "The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, can not be doubted; much less can it be doubted that it could impose such a tax on the income of

the current year, though part of that year had elapsed when the statute was passed."

The foregoing language of the Court was quoted with approval by Mr. Chief Justice White in the case of Brushaber vs. Union Pacific Railway Company, 240 U. S. 1, at Page 20.

III.

The effect of making the act retroactive to the first day of the year was to make it applicable to all persons, associations and corporations subject to the tax, who or which were living or in existence during any part of the taxable period. It is admitted that the Boss & Peake Automobile Co. was in existence as a corporation on January 1, 1917, and remained in existence until it was formally dissolved according to law on July 17, 1917. It is an undisputed fact that while it was in existence and doing business during the first part of the year 1917, it was in receipt of income to the amount reported by the agents of the Bureau of Internal Revenue. It is immaterial that the corporation was dissolved prior to the passage of the revenue act of 1917. It was subject to the Act for the time of its actual existence during the year. The Act, so far as the income and excess profits provisions were concerned, was in effect from the first

day of the year and every day during the year as long as the corporation remained in existence. In the case of the United States vs. McHatton, et al., 266 Fed. 602, which was a case very similar to this, arising under the Revenue Act of 1916, the complaint alleged that a Montana Corporation sold all its property, distributed the proceeds to stockholders, including the defendants, and thereby became dissolved, owing taxes to the United States. Judge Bourquin in his opinion said:

> "It was the corporation's duty to pay all taxes lawfully imposed upon it. Taxes can be thus imposed by retrospective law. Brushaber vs. Railway Company, 241 U. S. 20 * * * The corporate duty of payment cannot be escaped by dissolution. U. S. vs. Loading Co., 192 Fed. 223 * * * Brady Case, 240 Fed. 665."

The Brady case, (Brady et al. vs. Anderson, 240 Fed. 665) referred to by the Court in the McHatton case, arose under the Income Tax Act of October 3, 1913. Anthony N. Brady died July 22, 1913, and his executors, in accordance with the requirements of the Commissioner of Internal Revenue, made a return of the income received by him between March 1, 1913, when the Act went into effect, and July 22, 1913, when he died. The executors paid the tax under

protest and sued for its recovery. The court directed a verdict for the defendant, and the plaintiff appealed to the Circuit Court of Appeals for the Second Circuit by writ of error. The judgment of the District Court was confirmed and the United States Supreme Court on May 21, 1917, refused to grant a writ of certiorari in this case. The Circuit Court of appeals in sustaining the decision of the District Court said:

> "The effect of making the Act retroactive is, in our opinion, to apply it to Brady exactly as if it had been enacted March 1, 1913, and as, by reason of his death, he can not make a return. his executors, into whose hands his estate has come, must do so."

IV.

The theory that former stockholders of a dissolved corporation, who have received the assets of the corporation upon the dissolution thereof, are liable for taxes due the United States is well established. It is a well settled principal in American law that the assets of a corporation, if its debts are not paid before dissolution, become a trust fund chargeable with the debts of the corporation. The so-called trust fund doctrine applied to corporations as formulated by Mr. Justice Story in Wood vs. Dummer, 3

Mason, 308, Fed. Cas. No. 17944, is now so generally accepted by the Courts that argument to show that it exists would be imposing upon this Court's time. One of the late decisions, which we will take the liberty of quoting, was rendered by Mr. Justice Brandeis in the case of Pierce et al. vs. United States, 41 Sup. Ct. 365, decided March 7, 1921, in which it was said:

> "The law which sends a corporation into the world with a capacity to act, imposes upon its assets a liability for its acts. The corporation cannot disable itself from responding by distributing its property among its stockholders, and leaving remediless those having valid claims. In such a case the claims, after being reduced to judgments, may be satisfied out of the assets in the hands of the stockholders."

What is said of the assets of a dissolved corporation constituting a trust fund for the payment of the debts of the corporation, applies with equal force to unpaid taxes due from the corporation to the United States, for while taxes are no debt in the ordinary sense of the word, they are a higher form of obligation.

> Marshall vs. People of the State of New York, 41 Sup Ct. 143.

First National Bank of Houston et al. vs. Ewing et al., 108 Fed. 168.

V.

The stockholders' liability is several and may be enforced against one or more of the stockholders to the extent of distributive share of the corporate assets actually received. By the weight of authority cited above, the liability of a stockholder of a dissolved corporation is not limited to a pro rata contribution toward the payment of the corporate debts, but extends to the distributive share of the corporate assets actually received. Following the trust fund doctrine, the foundation of the action is that certain of the corporate assets have been transferred to stockholders, who hold the same, upon the company being dissolved, under a constructive trust for the benefit of and subject to that relation and that consequently the liability is for the amount they received or in the case of unpaid stock subscriptions, the amount they are withholding, the creditors having the same right to pursue such assets as if they were still within the hands of the corporation. In such early cases as Railroad Company vs. Howard, 7 Wall 392; Mumma vs. Potomac Co., 8 Pet. 281 and Curran vs. Arkansas, 15 Howard, 304, we find dicta to the effect that the stockholder's liability should be limited to a pro rata

contribution toward payment of the debt. This doctrine has found no place in the decision of later cases where this question was actually at issue. It was undoubtedly based on the theory that this liability is a personal one determined by the proportionate holding of each stockholder to the entire stock in the corporation. The personal liability of a stockholder as such at law, which is determined almost everywhere by statute, has been confused with this liability under the trust fund doctrine which excludes all idea of personal liability of stockholders **as such.**

In Fidelity Trust Company vs. McKeithen Lumber Company, 212 Fed. 239, where the individual stockholders were sued by a creditor after the corporation had been dissolved and its assets distributed, the creditor was allowed to recover to the extent of the assets received by the stockholders in the distribution.

In the case of Pierce vs. United States, 257 Fed. 516, affirmed by the Supreme Curt in 41 Sup. Ct. 365, where an oil company, pending criminal prosecution by the United States, which resulted in a judgment imposing a fine, sold all of its property and distributed the proceeds among its stockholders, the Circuit Court of Appeals affirmed the decree of the lower court holding stockholders liable in a creditor's bill

for the judgment against the corporation to the extent of their distributive shares of its funds. The entire trend of the decisions cited above is to the effect that stockholders who receive the assets of a corporation upon dissolution are severally liable for corporate debts to the extent of the funds or assets which they receive. This principal of law being true, this appellee having recovered a decree against the appellant Boss maintains therefore, that it is not imperative that the decree should also include the appellee Peake, even under the theory that Peake did receive a portion of the assets upon dissolution. That is a matter to be determined between Boss and Peake themselves and in which this appellee cannot be a party.

VI.

It appears from the record that there is testimony introduced on behalf of both Boss and Peake which testimony is in part conflicting. The trial court has viewed the witnesses and their manner of testifying and it is a well established principle that where there is substantial evidence to support a finding of fact, that the finding made by the trial court will be given great weight and respect by the appellate court. In this case the appellee Peake has introduced testimony tending positively to show that he merely sold his

stock in the corporation to the appellant and that the transaction did not assume the nature of a dissolution and distribution of the assets.

Judge Wolverton in deciding the case obviously weighed the testimony given on both sides, and having had the opportunity to observe the witnesses and their manner of testifying, decided to give greater weight to the testimony of Peake. It is a well established principle that findings of fact by a trial court in an equity case are presumptively correct and will not be disturbed on appeal unless it appears that some serious mistake was made in the consideration of the evidence. In this connection may be cited the case of the Board of Commissioners vs. Irvine, 126 Fed. 689, 698, in which the court said:

> "The findings thus challenged are findings of fact, and the rule is well established in this court by repeated decisions that the conclusion reached by a chancellor on a question of fact will be presumed to be correct, and will not be disturbed on appeal unless it appears that some serious mistake was made by the chancellor in the consideration of the evidence on which the conclusion was based. Even in chancery cases the conclusion of the lower court as respects questions of fact is entitled on appeal to great weight, and

will not be reversed unless the complaining party succeeds in showing very clearly that it is erroneous and ought to be overruled."

The argument as to questions of fact arising during the trial are amply covered by the brief of appellee E. W. A. Peake and will, therefore, not be duplicated in this brief.

It is, therefore, respectfully submitted that, disputed facts having been decided by the trial court against the appellant and there being no serious mistake on the part of the trial court appearing in the record, the decree of the court be sustained as rendered.

Respectfully submitted,

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Service of three copies admitted this.....

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